



Memorandum

Date . NOV 13 1992

From Bryan B. Mitchell *Bryan Mitchell*
Principal Deputy Inspector General

Subject Virginia Mason Hospital, Seattle, Washington, Review of
General and Administrative and Fringe Benefit Costs for the
Year Ended December 31, 1990 (A-10-92-00008)

To William Toby, Jr.
Acting Administrator
Health Care Financing Administration

This memorandum alerts you to the issuance on November 16, 1992 of our final audit report. A copy is attached.

The report presents the results of our review of general and administrative (G&A) and employee fringe benefit costs at Virginia Mason Hospital (VMH), Seattle, Washington, for the year ended December 31, 1990. Our review at VMH was part of a nationwide effort that was performed at the request of the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, House of Representatives.

The objectives of our review included determining if the G&A and fringe benefit costs reported by VMH were allowable, reasonable, and allocable in accordance with Medicare cost principles. We also determined the relationship of these costs to patient care activities and whether the costs might be perceived as extravagant or otherwise inappropriate.

The VMH reported G&A and fringe benefit costs totaling \$8,954,703 and \$6,631,209, respectively, as subject to allocation to Medicare for the year ended December 31, 1990. Our review disclosed that these amounts included \$225,256 in G&A costs and \$3,466 in fringe benefit costs which were not allowable for allocation to Medicare. The unallowable costs included:

- o advertising and other costs which were promotional in nature, (ii) training costs for a related entity's employees,
- o various costs not supported by adequate documentation,
- o lobbying costs,

- o contributions to charitable and civic organizations,
- o membership dues unrelated to patient care, and
- o other miscellaneous unallowable charges.

Under the prospective payment system (PPS), the unallowable costs that we identified had no direct effect on inpatient reimbursement. These costs directly affected only the Medicare reimbursement for outpatient services and VMH's Rehabilitation Unit, which was excluded from PPS. We are recommending that the fiscal intermediary, Blue Cross of Washington and Alaska, adjust for the \$228,722 in unallowable costs identified by our audit of VMH's Medicare cost report for the year ended December 31, 1990.

Our review also disclosed \$12,444 in G&A costs and \$25,846 in fringe benefit costs which we have identified as costs of concern. While these costs were not specifically unallowable under Federal guidelines, there is some concern on the appropriateness of the costs. Recent congressional hearings on colleges and universities have raised some question on whether these types of costs should be allocated to Federal programs. These costs included expenditures for gifts, plaques, employee functions, portraits, photos, framing work, service awards, flowers, plants, and balloons.

In addition, for the year ended December 31, 1990, VMH made adjustments which reduced G&A costs by \$590,464 and fringe benefit costs by \$193,586 in the Medicare cost report. Included in the G&A adjustments was \$120,704 incurred for a quarterly health magazine that we considered promotional in nature and unnecessary in providing patient care.

In VMH's response to our findings, the hospital generally disagreed with most of our conclusions that the questioned costs were not allowable or related to patient care. The VMH stated that all the items included in this report were expenditures that are appropriate for a well-run hospital even though Medicare may choose not to pay for them all.

After reviewing VMH's comments, we concluded that the unallowable costs of \$228,722 identified by our audit were properly determined, and that the recommended adjustment to the cost report was appropriate.

For further information contact:
Herbert Witt
Regional Inspector General for
Audit Services, Region IX
(415) 556-5766

Attachment



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Region IX
Office of Audit Services
50 United Nations Plaza
San Francisco, CA 94102

Common Identification Number A-10-92-00008

Mr. Ned Borgstrom
Chief Financial Officer
Virginia Mason Medical Center
1100 Ninth Avenue
P.O. Box 900
Seattle, Washington 98111

Dear Mr. Borgstrom:

Enclosed are two copies of an Office of Inspector General, Office of Audit Services report entitled, "VIRGINIA MASON HOSPITAL, SEATTLE, WASHINGTON, REVIEW OF GENERAL AND ADMINISTRATIVE AND FRINGE BENEFIT COSTS FOR THE YEAR ENDED DECEMBER 31, 1990."

Your attention is invited to the audit findings and the recommendation contained in the report. The Department of Health and Human Services (HHS) official named below will be communicating with you in the near future regarding implementation of the recommendation.

Associate Regional Administrator
Division of Medicare
Health Care Financing Administration
2201 Sixth Avenue, M/S: RX-44
Seattle, Washington 98121

Final determination as to the actions to be taken on all matters reported will be made by this HHS official. We request that you respond to the recommendation in this report within 30 days from the date of this letter to the HHS official named, presenting any additional comments or information that you believe may have a bearing on his final determination.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), Office of Audit Services reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR Part 5.)

Page 2 - Mr. Ned Borgstrom

To facilitate identification, please refer to Common Identification Number A-10-92-00008 in all correspondence relating to this report.

Sincerely,

A handwritten signature in dark ink, appearing to read "Herbert Witt", is written over the typed name.

Herbert Witt
Regional Inspector General
for Audit Services

Enclosure

SUMMARY

This report presents the results of our review of general and administrative (G&A) and employee fringe benefit costs at Virginia Mason Hospital (VMH), Seattle, Washington, for the year ended December 31, 1990. Our review at VMH was part of a nationwide effort that was performed at the request of the Subcommittee on Oversight and Investigations (Subcommittee) of the Committee on Energy and Commerce, House of Representatives. The Subcommittee is conducting an inquiry into the health care system.

The VMH was 1 of 21 hospitals selected nationwide for review by the Office of Inspector General (OIG), Department of Health and Human Services. This hospital was selected in accordance with our objective to include a geographic representation of hospitals nationwide.

The objectives of our review included determining if the G&A and fringe benefit costs reported by VMH were allowable, reasonable, and allocable in accordance with Medicare cost principles. We also determined the relationship of these costs to patient care activities and whether the costs might be perceived as extravagant or otherwise inappropriate.

Hospitals are, for the most part, reimbursed under the Medicare program for G&A and employee fringe benefit costs through fixed payments determined in advance under the prospective payment system (PPS). These payments are based on the volume and type of services performed, regardless of actual costs. However, a small portion of these costs, the costs related to outpatient services and excluded units, is initially reimbursed based on submitted charges. These charges are subsequently adjusted to reflect the lower of allowable costs or charges.

The VMH reported G&A and fringe benefit costs totaling \$8,954,703 and \$6,631,209, respectively, as subject to allocation to Medicare for the year ended December 31, 1990. Our review disclosed these amounts included \$225,256 in G&A costs and \$3,466 in fringe benefit costs which were not allowable for allocation to Medicare. The unallowable costs included:

- o advertising and other costs which were promotional in nature,
- o training costs for a related entity's employees,
- o various costs not supported by adequate documentation,
- o lobbying costs,
- o contributions to charitable and civic organizations,
- o membership dues unrelated to patient care, and

- o other miscellaneous charges unallowable for reimbursement.

Under PPS, the unallowable costs that we identified had no direct effect on inpatient reimbursement. These costs directly affected only the Medicare reimbursement for outpatient services and VMH's Rehabilitation Unit, which was excluded from PPS. We are recommending that the fiscal intermediary (FI), Blue Cross of Washington and Alaska, adjust for the \$228,722 in unallowable costs identified by our audit of VMH's Medicare cost report for the year ended December 31, 1990.

Our review also disclosed \$12,444 in G&A costs and \$25,846 in fringe benefit costs which we have identified as costs of concern. Our review of these costs is reported under OTHER MATTERS. While these costs were not specifically unallowable under Federal guidelines, there is some concern on the appropriateness of the costs. Recent congressional hearings on colleges and universities have raised some question on whether these types of costs should be allocated to Federal programs. These costs included expenditures for:

- o gifts and plaques;
- o various employee functions;
- o portrait, photo, and framing work;
- o service awards; and
- o flowers, plants, and balloons.

In addition, for the year ended December 31, 1990, VMH made adjustments which reduced G&A costs by \$590,464 and fringe benefit costs by \$193,586 in the Medicare cost report. Our review of these adjustments is reported under OTHER MATTERS. Included in the G&A adjustments was \$120,704 incurred for a quarterly health magazine that we considered promotional in nature and unnecessary in providing patient care. The remainder of the adjustments primarily represented accounting entries to offset related income against costs, and to eliminate unallowable patient telephone expenses.

In VMH's response to our findings, the hospital generally disagreed with most of our conclusions that the questioned costs were not allowable or related to patient care. The VMH stated that all the items included in this report were expenditures that are appropriate for a well-run hospital even though Medicare may choose not to pay for them all.

After reviewing VMH's comments, we concluded that the unallowable costs of \$228,722 identified by our audit were properly

determined, and that the recommended adjustment to the cost report was appropriate. We have incorporated VMH's comments and the OIG's response to those comments after each finding discussed in this report. The full text of VMH's comments is included in EXHIBIT C in this report.

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INTRODUCTION

We reviewed the G&A and fringe benefit costs reported by VMH for the year ended December 31, 1990. The objectives of our review included determining if the G&A and fringe benefit costs were allowable, reasonable, and allocable in accordance with Medicare cost principles. We also determined the relationship of these costs to patient care activities and whether the costs might be perceived as extravagant or otherwise inappropriate.

Background

The VMH, located in Seattle, Washington, is a nonprofit corporation and a controlled affiliate of the Virginia Mason Medical Center, also a nonprofit corporation. The Virginia Mason Medical Center includes the 336 bed hospital, a large clinic with 10 local satellite facilities, and a research center.

For the year ended December 31, 1990, VMH reported total hospital operating costs of \$94.4 million before reclassifications and adjustments. The net amount subject to allocation to Federal programs was \$82.8 million.

Included in the hospital's operating costs were G&A costs totaling \$11,131,715. These costs were reduced by the hospital to \$8,954,703 through adjustments of \$590,464 and reclassifications of \$1,586,548. The VMH also reported fringe benefit costs totaling \$6,779,340, which were reduced to \$6,631,209 through net adjustments and reclassifications of \$193,586 and (-\$45,455), respectively.

In the request to the OIG, the Subcommittee stated that it was conducting an inquiry into the nation's health care system. Specifically, the Subcommittee was evaluating trends in access to care and the quality of care, and assessing the factors that contribute to rapidly rising health care costs.

The most common method of reimbursement under Medicare is known as PPS, which was established by the Social Security Amendments of 1983. Today, there are about 6,520 hospitals participating in the Medicare program. About 5,480 of these hospitals, or 84 percent, are reimbursed for inpatient care under PPS. The VMH is a PPS hospital and, in 1990, over 50 percent of the hospital's charges were for services provided to Medicare patients.

Under PPS, Medicare's payment for Part A hospital inpatient operating costs is made prospectively on a per discharge basis. The discharges are classified into diagnostic related groups (DRG). Hospitals under the PPS reimbursement methodology are reimbursed for inpatient services through fixed DRG payments that are based on the volume and type of service performed, regardless of actual costs. In short, these payments are analogous to "at risk, fixed price contracts" that permit hospitals to make more

or less money in treating Medicare patients, depending on how they manage in the aggregate.

Since PPS hospitals receive the same payment for a particular DRG regardless of its costs, inappropriate G&A costs have no immediate direct effect on Medicare reimbursement to these hospitals for inpatient services provided to Medicare beneficiaries. Such inappropriate overhead expenditures, however, do directly affect their Medicare reimbursement for outpatient services and for services provided by their excluded units. Excluded units are psychiatric, rehabilitation, and alcohol/drug units of general hospitals. Medicare's direct allocation of costs at VMH was about 4.3 percent in 1990.

Scope

The objectives of our review were to analyze G&A and fringe benefit costs to determine: (i) if such costs were allowable, reasonable, and allocable under Medicare cost principles; (ii) the nature of the costs and their relationship to patient care activities; and (iii) those types of costs which may be perceived to be extravagant or otherwise inappropriate.

To accomplish our objectives, we reviewed transactions selected from the G&A and fringe benefit accounts identified in VMH's Hospital and Health Care Cost Report (HCFA-2552) for the year ended December 31, 1990. We also reviewed similar costs incurred but not included in the cost report. In selecting costs for analysis, we included only those items which we believed had the greater risk of noncompliance with Federal regulations. Therefore, the results of our analysis cannot be considered to be representative of the overall operations of VMH.

Our review was made in accordance with generally accepted government auditing standards to the extent that they were applicable to the scope of our review as defined in an audit guide provided by the lead region. The audit guide was developed to ensure adequate audit coverage of the concerns expressed by the Subcommittee. The audit guide was limited to these concerns and, as such, a review of internal controls was not performed. We reviewed VMH's audited financial statements and accompanying auditors' report for the years ended December 31, 1989 and 1990.

The field work was performed by our Seattle field office staff during the period February through April 1992.

FINDINGS AND RECOMMENDATION

Of the \$15,585,912 in G&A and fringe benefit costs VMH reported as subject to allocation to Federal programs, we determined that \$228,722 was unallowable under criteria contained in Part 1 of the Medicare Provider Reimbursement Manual (PRM). The unallowable costs included \$225,256 in G&A costs and \$3,466 in fringe benefit costs. (See EXHIBIT A for the schedule of unallowable costs.) We summarized the costs under the following categories:

- o advertising and other promotional costs amounting to \$200,421,
- o training costs for a related entity's employees of \$11,720,
- o costs not supported by adequate documentation totaling \$4,983,
- o lobbying costs of \$4,222,
- o charitable and civic contributions amounting to \$3,276,
- o membership dues of \$1,357 not related to patient care, and
- o miscellaneous charges of \$2,743 not allowable for reimbursement.

The Medicare cost principles in section 2102.3 of the PRM provide that:

"Costs not related to patient care are costs which are not appropriate or necessary and proper in developing and maintaining the operation of patient care facilities and activities. Such costs are not allowable in computing reimbursable costs."

The PRM also requires that cost information as developed by the provider must be current, accurate, and in sufficient detail to support payments made for services rendered to beneficiaries. In addition, the Provider Reimbursement Review Board (PRRB) has issued some relevant decisions on the reimbursement of specific costs as discussed in the following pages.

Advertising and Other Promotional Costs

We identified \$200,421 in advertising and other promotional costs which are unnecessary in providing patient care and unallowable for reimbursement. These costs primarily included the costs associated with a television advertising campaign. Section

2136.2 of the PRM provides that costs of advertising to the general public which seeks to increase patient utilization of the provider's facilities are not allowable for reimbursement by Medicare.

The total cost of the television advertising campaign was shared equally between the hospital and the clinic. The campaign costs borne by the hospital totaled \$191,142 and included costs for the production and running of six different commercials concerning the Virginia Mason Medical Center. We viewed a videotape of the commercials and noted that the themes included heart disease, diabetes, cancer, integrated care, and the satellite clinic facilities.

In addition to the television advertising, our review disclosed that \$9,279 was spent on other advertising and promotional activities unrelated to patient care and not allowable for reimbursement. Specifically, this included expenditures for:

- o a trip to Pacific Rim countries to promote referrals to the hospital (\$5,109);
- o various print advertisements (\$2,049);
- o a booth on women and children's health services at the Northwest Women's Show (\$1,621);
- o cooking classes that were open to the public (\$250); and
- o participation in Health Care '91 in Tokyo, Japan (\$250).

VMH Comments

The VMH stated that the PRM allows advertising and promotional costs if the advertising helps to present a good public image and communicate the availability of covered services. The VMH maintained that the questioned media advertising was intended to inform the public of the availability of services. Also, the cooking classes and the activities with Pacific Rim health care organizations were part of maintaining a good public image. Lastly, VMH commented that the expenditure for a booth describing women's health services was intended to inform the public of those services.

OIG Response

The advertising and promotional costs, totaling \$200,421, are not allowable for Medicare reimbursement. The PRM, section 2136.1, provides that advertising costs are allowable if the advertising is primarily concerned with presentation of a good public image

and directly or indirectly related to patient care. Communicating the availability of services to the general public is not defined by the manual as an allowable cost. The PRM provides that advertising to the general public which seeks to increase patient utilization is unallowable for reimbursement.

The hospital's media advertising was widely distributed and directed to the general public. The commercials were broadcast locally over eight different networks, including several nationally-affiliated networks, and run usually during peak viewing hours. The print advertisements were placed into general circulation in magazines and newspapers.

Similarly, the booths and the cooking classes were open to the general public and unrelated to patient care. The trips to the Pacific Rim countries were to promote referrals, which is also unrelated to patient care. Some of the advertising or promotional activities may have had as a by-product the improvement of public image, but that did not appear to be the primary goal.

Related Entity Training Costs

Included in VMH's G&A accounts allocated to Medicare was \$11,720 in training costs for a related entity's employees. Since these costs are not hospital costs, they are not allowable for reimbursement.

Hospital and clinic employees attended continuous quality improvement and leadership training courses. The hospital was billed and paid for the total cost of the training. No adjustment was made to transfer the costs for the training of the clinic's employees from the hospital's G&A accounts to the clinic's accounts.

VMH Comments

The VMH stated that, although the physicians and administrators were employees of the clinic, a related entity, all of them were closely involved in hospital operations and it was appropriate for the hospital to pay for their training expenses.

OIG Response

While the physicians and administrators may have been involved with hospital operations, they were still employees of the clinic. The clinic and hospital are related, but separate nonprofit organizations.

We found other instances when the clinic and hospital employees jointly attended training classes and the cost of the training was properly allocated to the two organizations. Thus, the

inclusion of \$11,720 in training costs for clinic employees in the hospital G&A account was inconsistent treatment of costs. We maintain that since the training costs were not for hospital employees, the costs are unallowable for Medicare reimbursement.

Unsupported Costs

Our review disclosed that VMH could not support \$4,983 in charges with adequate documentation of cost and/or business purpose. Thus, these costs are not allowable for reimbursement by Medicare. Section 2304 of the PRM provides that cost information as developed by the provider must be current, accurate, and in sufficient detail to support payments made for services rendered to beneficiaries.

The types of costs not supported varied and included expenditures purportedly for flowers, gift certificates, a photo, employee and volunteer functions, meeting expenses, training, and travel. The VMH officials did not provide invoices and/or receipts to support \$3,745 in charges. Thus, the type of expenditure could not be verified. Also, \$817 in costs lacked a documented business purpose. The remainder, or \$421, was neither supported with invoices nor receipts, nor had a business purpose documented.

VMH Comments

The VMH provided specific comments on \$2,624 of \$4,983 in questioned costs. The VMH stated that these costs were properly supported by check requests and approved by the appropriate managers, but hospital files failed to include the original vendor invoices. The VMH agreed that the paper trail could be improved, but believed that the existing documentation supported the expense. The VMH did not provide comments on the balance of \$2,359.

OIG Response

The VMH acknowledged in the response that, in several cases, it could not support costs with the original vendor invoice and that the paper trail could be improved. Adequate documentation is a prerequisite to support that a provider's costs are reasonable and related to patient care.

In addition to requiring cost information to be current, accurate, and in sufficient detail to support payments, section 2304 of the PRM explains that sufficient detail includes all ledgers, books, records, and original evidence of cost. The vendor invoice, not a check request generated by hospital employees, is the original evidence of cost. Since the hospital was unable to provide vendor invoices and/or documentation of business purpose, the \$4,983 in costs was not allowable for reimbursement.

Lobbying Costs

We found that VMH had lobbying costs, totaling \$4,222, which were not necessary for patient care. This included \$3,222 for membership dues, a registration fee, and travel expenses paid to participate in the Committee for Affordable Health Care (CAHC). The CAHC has an objective to influence public policy and, therefore, appears to be a lobbying organization. The remainder of the lobbying costs identified, or \$1,000, was paid to Citizens for Education to support a voter proposition.

VMH Comments

The VMH believes that the expenditures to participate in the CAHC and to support Citizens for Education are appropriate and responsible. The VMH described the CAHC as a broad-based group working with policy makers and others to respond meaningfully to problems in the existing health care system. The VMH added that lobbying was a small part of the committee's activities. The VMH described the Citizens for Education as a group that was trying to pass a school levy, which the hospital views as essential for training future employees.

OIG Response

We consider the \$4,222 in lobbying costs to be unrelated to patient care and unallowable for reimbursement. The VMH did not provide documentation to support the assertion that lobbying was only a small part of CAHC's activities. Also, the hospital's response confirmed that the donation to the Citizens for Education was to support a voter proposition regarding a school levy and, therefore, represented an unallowable lobbying cost.

Charitable and Civic Contributions

Our audit disclosed \$3,276 in unallowable costs for contributions to charitable and civic organizations. The PRRB stated, in Decision Number 80-D88, that payments made to specific civic and charitable organizations did not constitute Medicare reimbursable costs, as they were not related to patient care.

A majority of the charitable contributions (\$3,000), were made to the Partners in Public Education (PIPE). The remainder included donations to scholarship funds (\$210), the Boys and Girls Club of Sequim to support a charity auction (\$50), and the Public Relations Society of America Foundation (\$16).

VMH Comments

The VMH stated that the contributions of \$3,000 to PIPE were related to patient care by the training of future employees. The VMH described PIPE as a civic organization that was organized to

bring community businesses and high school students closer together.

The VMH noted that the PRM, section 2138.2, allows dues, special assessments, and meeting expenses for civic organizations. The hospital asserts that participation in PIPE meets that definition. The hospital added that the circumstances discussed in the above PRRB decision are different than those discussed in this report. Also, VMH commented that PRRB decisions are not binding on the hospital or its FI.

The VMH did not address the donations to scholarship funds, the charity auction, or the Public Relations Society of America Foundation.

OIG Response

The contributions to PIPE do not meet the definition at PRM, section 2138.2. This section deals with membership costs and not civic and charitable contributions.

Several PRRB decisions, including Decisions Number 80-D88, 81-D12, 83-D41, and 84-D9, provided that civic and charitable contributions are not Medicare reimbursable costs because the costs are not related to patient care. The PRRB has stated that the relationship between the delivery of patient care and civic and charitable contributions was extremely remote. Although particular PRRB decisions may not be binding on the hospital or its FI, the decisions set a precedence to rely on when evaluating costs.

Membership Dues

We found that VMH paid \$1,357 in dues for social clubs and other organizations not related to patient care. Section 2138.3 of the PRM states that provider costs incurred in connection with memberships with social, fraternal, and other organizations unrelated to their members' business activities are not allowable because their objectives and functions are not related to the care of beneficiaries.

The VMH paid \$1,027 in dues and club assessments for the hospital administrator to be a member of a luncheon club which he rarely used in 1990. The VMH also paid \$330 in other dues unrelated to patient care. This included dues paid to Xplor Northwest, American-Korea Trade Club, Wing Luke Asian Museum, Japan-American Society, Sister Cities International, and the World Affairs Council.

VMH Comments

The VMH stated that the hospital administrator's membership in the luncheon club was used purely for business meetings with physicians and others, and not for general social purposes. The VMH commented that the remaining membership dues to a variety of organizations were related to increasing the hospital's visibility among the Asian communities in Seattle. The VMH asserted these organizations meet the definition of PRM, section 2138.2, as to allowability under Medicare.

OIG Response

In 1990, monthly statements from the luncheon club indicated that the hospital administrator rarely used the club for business purposes. The administrator used the club for luncheon meetings on three occasions in 1990, of which only one was documented as being related to hospital patient care services. The remaining luncheons included: (i) a meeting to discuss a nursing home and retirement complex on the medical center campus and (ii) a meeting with three physicians with no documented business purpose. We do not consider it reasonable for Medicare to participate in \$1,027 for membership costs in a club that was rarely used for purposes related to patient care.

Section 2138.2 of the PRM allows membership dues for organizations which function for the purpose of implementing civic objectives. The VMH did not provide documentation to support the assertion that \$330 in membership dues paid to a variety of organizations met the definition of allowable dues for civic organizations. Accordingly, we consider the dues to be unallowable for reimbursement under Medicare.

Other Miscellaneous Charges

We determined that \$2,743 in miscellaneous charges were not related to patient care and were unallowable for Medicare reimbursement. These unallowable costs included:

1. travel costs of \$1,113 consisting of payments for (a) room and meal charges for family members of employees, (b) an upgrade to first-class air travel contrary to VMH policy, (c) travel by an employee and his spouse that was reimbursed by another hospital but not credited to the VMH's G&A cost center, (d) travel costs previously paid for (duplicate payment), and (e) flight instruction.
2. expenses related to an annual golf tournament open only to VMH management staff totaling \$555.

3. alcohol primarily consumed at an employees' recognition dinner, as well as during various meetings totaling \$468. In PRRB Decision Number 80-D84, the PRRB disallowed costs for the purchase of alcoholic beverages on the basis that such costs were not related to patient care.
4. supplies costing \$294, not related to patient care including (a) a T-shirt, poster, key chain, and souvenir pins bought while employees were in travel status; (b) a 2-inch black and white Watchman and candy purchased as supplies for a booth; and (c) Christmas calendar cards sent to the business community and referring physicians.
5. meals and miscellaneous charges unrelated to hospital patient care amounting to \$187. These charges included payments for (a) luncheon meetings to discuss building a nursing home and retirement complex and business opportunities in the Soviet Far East, (b) a cultural affairs program which celebrated the harvest moon, (c) catering services for a physician support group meeting, and (d) parking for a meeting regarding a related entity.
6. late and no-show charges of \$126 which could have been avoided. Section 2103 of the PRM provides that a prudent and cost-conscious buyer will seek to economize by minimizing cost.

VMH Comments

The VMH agreed that \$744 of the \$2,743 was unallowable for reimbursement. This included \$569 of the \$1,113 in travel costs, \$49 of the \$294 in questionable supplies, and the \$126 in late and no-show charges. For the remaining questioned costs, totaling \$1,999, VMH asserted that the costs were appropriate and/or normal expenses. In addition, VMH noted that neither an indication of a first-class upgrade nor a duplicate payment was found.

Regarding the discussion of alcoholic beverages, the hospital commented that the PRRB decision disallowing the cost of alcohol was not binding on the hospital or its FI, and that the facts were somewhat different in this case.

The VMH did not address the T-shirt, poster, key chain, and souvenir pins bought by an employee while in travel status.

OIG Response

Although VMH considered the balance of \$1,999 in miscellaneous costs to be appropriate and normal expenses, the costs were not related to patient care and, therefore, were unallowable for Medicare reimbursement.

Regarding VMH's comment concerning costs for alcoholic beverages, we agree that particular PRRB decisions may not be binding on the hospital or its FI. However, the decision sets a precedence to rely on when evaluating costs. Further, the Health Care Financing Administration's Deputy Administrator, in a decision dated October 15, 1991, disallowed the costs of alcoholic beverages as fringe benefits for employees of providers, citing sections 2102.1 and 2102.2 of the PRM. These PRM sections provide that the costs must be reasonable and related to patient care.

In response to VMH's comments on finding no indication of a first-class upgrade or duplicate payment, we provided a VMH official with a copy of the invoices for the upgrade and duplicate payment.

Recommendation

We recommend that the FI, Blue Cross of Washington and Alaska, adjust for the \$228,722 in unallowable costs identified by our audit of VMH's Medicare cost report for the year ended December 31, 1990.

OTHER MATTERS

COSTS OF CONCERN

Of the \$15,585,912 in G&A and fringe benefit costs VMH reported as subject to allocation to Federal programs, we identified \$38,290 as costs of concern. While these costs were not specifically unallowable under Federal guidelines, there is some concern on the appropriateness of the costs. Recent congressional hearings on colleges and universities have raised some question on whether these types of costs should be allocated to Federal programs. These costs included \$12,444 in G&A costs and \$25,846 in fringe benefit costs. (See EXHIBIT B for the schedule of costs of concern.) We categorized these costs as follows:

- o gifts and plaques totaling \$11,343;
- o various employee functions of \$8,695;
- o portrait, photo, and framing work amounting to \$7,447;
- o service awards of \$6,669; and
- o flowers, plants, and balloons totaling \$4,136.

Gifts and Plaques

Our review identified costs subject to allocation to the Federal programs totaling \$11,343 for a variety of gifts and plaques. A majority, or \$8,542, of the gifts identified were retirement gift checks. The VMH personnel policies and procedures provide that each vested employee who retires under the retirement plan provisions is eligible for a retirement gift of \$75 if length of service was less than 5 years, or \$25 per year of service with 5 years or more. The remainder of gifts noted included gift certificates, a perfume bottle, candy, an executive water set, clocks, crystal boxes, camera equipment, and plaques.

Employee Functions

We identified \$8,695 in charges for various employee functions. These costs pertained to a retiree luncheon, employee softball team, employee picnics, retirement and farewell parties, department lunches and celebrations, and employee recognition dinners. Any liquor costs related to these events have been questioned as unallowable and are discussed elsewhere in this report.

Portraits, Photos, and Framing Work

We found that costs incurred by the hospital for portraits, photos, and framing work amounted to \$7,447. These costs primarily included photos of the Board of Directors, but also included portraits of doctors, prints, and framed pictures and certificates.

Service Awards

Our review disclosed \$6,669 in service awards provided by VMH to its employees. These awards consisted of (i) \$5,619 for gold service pins provided to employees with 5, 10, 15, 20, and 25 years of service with VMH and (ii) \$1,050 in gift certificates to restaurants for service pin recipients with 20 years or more service.

Flowers, Plants, and Balloons

We identified \$4,136 in costs for flowers, plants, and balloons. According to a VMH official, there is no hospitalwide policy on the purchase of flowers, plants, or balloons, except when purchased for quarterly service award teas. Instead, it is up to the individual departments to establish a policy and stay within their budget. The VMH procedures for the service award teas detail the flowers to be purchased, including centerpieces, corsages, and boutonnieres.

In addition to service award teas, we noted that these items were purchased for VMH personnel to express sympathy, offer get well wishes, and provide congratulations on the birth of a baby. We also noted that they were purchased for events such as a farewell coffee, a rose show, and Christmas.

VMH Comments

The VMH stated that the costs categorized as costs of concern primarily relate to employee benefits - directly to individuals or indirectly to employees as a group - and also to activities of unpaid volunteer board members. The VMH explained that implementing policies that keep employees motivated to work effectively as a group is fundamentally related to high quality patient care.

The VMH commented that the amounts of money involved and the types of activity they relate to are appropriate. According to VMH, these activities are essential to governance of the hospital as a nonprofit organization and contribute to an atmosphere of cost-effective teamwork that has enabled VMH to keep its costs below costs of other hospitals.

OIG Response

As discussed in our report, these types of costs were not specifically unallowable. However, there has been some concern on the allocability of such costs to Federal programs. While some of these costs may have been cost effective, as indicated by VMH, we included the costs because they did not directly relate to patient care.

COSTS NOT ALLOCATED TO FEDERAL PROGRAMS

To comply with the Subcommittee's request, we also examined selected G&A and fringe benefit costs which were incurred by VMH but not allocated to Federal programs. For the year ended December 31, 1990, VMH made adjustments which reduced G&A costs by \$590,464 and fringe benefit costs by \$193,586 in the Medicare cost report.

We determined that \$120,704 of the G&A adjustments was incurred for a quarterly health magazine. Information provided to us by VMH indicated that about 95 percent of the magazine copies were distributed to the general public. Based on that information, we concluded that it was promotional in nature and unnecessary in providing patient care. In PRRB Decision Number 89-D57, the PRRB concluded that the costs attributable to the distribution of a health magazine to the general public is not an allowable cost related to patient care and does not meet the criteria for allowable advertising costs. The remainder of the adjustments primarily represented accounting entries to offset related income against costs and to eliminate unallowable patient telephone expenses.

VMH Comments

In response to our draft report, VMH pointed out that the cost of the magazine was voluntarily excluded from the cost report by the hospital and that no part of it was paid by the Medicare program. However, after receiving our draft report, VMH revised its statement that the magazine was primarily distributed to the general public. Instead, VMH asserted that it was distributed to the medical community, employees, and existing patients. The VMH also disagreed that the magazine was promotional in nature, but rather contributes to an understanding of the role and function of the hospital in providing covered services in the community.

The VMH now believes some of the cost of the magazine should be allowable for allocation to the Medicare program. The comments indicated the VMH will work with its FI to consider revising the amount adjusted for 1990 and subsequent years.

OIG Response

Our conclusions on the promotional nature of the quarterly magazine were based on information provided to us by VMH which indicated that about 95 percent of the magazine copies were distributed to general public. The revised statement by VMH, which changed the prior information provided to us, was not supported by verifiable documentation.

After receiving our draft report, VMH prepared an analysis which showed that 78 percent of the copies were distributed to the medical community, employees, existing patients, and other readers in the medical center. Under the PRM and related PRRB decisions, the related costs may be determined to be allowable under Medicare. The analysis also showed that the remaining 22 percent of the magazine copies were distributed to donors and public officials, and the related costs would not be allowable.

The analysis performed by VMH is preliminary, and VMH officials advised that they were attempting to gather documentation to support their assertions. If VMH initiates action to adjust prior cost reports to claim the costs of the magazine, it will need to provide verifiable information to the FI for review.

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In accordance with the principles of the Freedom of Information Act (Public Law 90-23), Office of Inspector General, Office of Audit Services reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR Part 5.)

EXHIBITS

VIRGINIA MASON HOSPITAL
SEATTLE, WASHINGTON
SCHEDULE OF UNALLOWABLE COSTS IDENTIFIED
IN THE G&A AND FRINGE BENEFIT ACCOUNTS
FOR THE YEAR ENDED DECEMBER 31, 1990

DESCRIPTION	GENERAL & ADMIN. AMOUNT	FRINGE BENEFIT AMOUNT	TOTAL AMOUNT
ADVERTISING AND OTHER PROMOTIONAL COSTS:			
Television Advertising Campaign	\$191,142	\$0	\$191,142
Pacific Rim Trip	5,109	0	5,109
Print Advertisements	2,049	0	2,049
Northwest Women's Show Booth	1,621	0	1,621
Cooking Class Open to Public	250	0	250
Health Care '91 Participation	250	0	250
SUBTOTAL	\$200,421	\$0	\$200,421
RELATED PARTY TRAINING COSTS:	\$11,720	\$0	\$11,720
UNSUPPORTED COSTS:			
Cost Not Supported Adequately	\$2,859	\$886	\$3,745
Business Purpose Not Documented	817	0	817
Both Cost & Purpose Not Supported	396	25	421
SUBTOTAL	\$4,072	\$911	\$4,983
LOBBYING COSTS:			
Committee for Affordable Health Care	\$3,222	\$0	\$3,222
Citizens for Education	1,000	0	1,000
SUBTOTAL	\$4,222	\$0	\$4,222
CHARITABLE CONTRIBUTIONS:			
Partners in Public Education	\$1,000	\$2,000	\$3,000
Other Donations	276	0	276
SUBTOTAL	\$1,276	\$2,000	\$3,276
MEMBERSHIP DUES:			
Social Club	\$1,027	\$0	\$1,027
Other Dues Unrelated to Patient Care	330	0	330
SUBTOTAL	\$1,357	\$0	\$1,357
MISCELLANEOUS:			
Travel	\$1,113	\$0	\$1,113
Annual Management Golf Tournament	0	555	555
Alcohol	468	0	468
Questionable Supplies	294	0	294
Meals & Miscellaneous	187	0	187
Late & No-Show Charges	126	0	126
SUBTOTAL	\$2,188	\$555	\$2,743
TOTAL UNALLOWABLE COSTS ALLOCATED TO MEDICARE PROGRAM	\$225,256	\$3,466	\$228,722

VIRGINIA MASON HOSPITAL
SEATTLE, WASHINGTON
SCHEDULE OF COSTS OF CONCERN IDENTIFIED
IN THE G&A AND FRINGE BENEFIT ACCOUNTS
FOR THE YEAR ENDED DECEMBER 31, 1990

DESCRIPTION	GENERAL & ADMIN. AMOUNT	FRINGE BENEFIT AMOUNT	TOTAL AMOUNT
GIFTS AND PLAQUES:			
Retirement Gift Checks	\$0	\$8,542	\$8,542
Plaques	723	312	1,035
Camera Equipment	478	0	478
Perfume Bottle and Candy	18	319	337
Crystal Boxes	286	31	317
Clocks	168	106	274
Gift Certificates	0	200	200
Executive Water Set	160	0	160
SUBTOTAL	\$1,833	\$9,510	\$11,343
EMPLOYEE FUNCTIONS:			
Subsidy of Employee Tickets to Picnic at Enchanted Village	\$0	\$5,648	\$5,648
Dept. Lunches/Picnics/Celebrations	1,015	0	1,015
Retirement and Farewell Parties	72	624	696
Employees Softball	0	532	532
Employee Recognition Dinners	502	0	502
Retirees Luncheon	0	302	302
SUBTOTAL	\$1,589	\$7,106	\$8,695
PORTRAITS, PHOTOS, AND FRAMING WORK:			
Photos of Board of Directors	\$5,316	\$0	\$5,316
Prints, Framed Pictures, and Certificates	1,401	420	1,821
Portraits	212	0	212
Other Photos	98	0	98
SUBTOTAL	\$7,027	\$420	\$7,447
SERVICE AWARDS:			
Service Pins	\$0	\$5,619	\$5,619
Award Dinners	100	950	1,050
SUBTOTAL	\$100	\$6,569	\$6,669
FLOWERS, PLANTS, AND BALLOONS:			
Flowers and Plants	\$1,772	\$2,047	\$3,819
Balloons	123	194	317
SUBTOTAL	\$1,895	\$2,241	\$4,136
TOTAL COSTS OF CONCERN ALLOCATED TO MEDICARE PROGRAM	\$12,444	\$25,846	\$38,290

Medical Center

May 27, 1992

Mr. Herbert Witt
Regional Inspector General
for Audit Services
Department of Health & Human Services
Region IX, Office of Audit Services
50 United Nations Plaza
San Francisco, California 94102

Dear Mr. Witt:

We have received your draft report, dated May 15, 1992, on your review of Virginia Mason Hospital's 1990 administrative and fringe benefit costs. We appreciate the opportunity to comment on the draft report before it is finalized. We also appreciate the professionalism and cordiality with which your staff approached its work.

Later in this letter, we will respond to the individual items mentioned in your report, but in general we would respond as follows:

- 1) Virginia Mason seeks to be in full compliance with Medicare regulations, and welcomes this audit as an opportunity for Congress and the Health Care Financing Administration to clarify areas of confusion in the regulations.
- 2) Virginia Mason has demonstrated the ability to deliver high quality care efficiently. Our case-mix adjusted charges are the lowest in Seattle. All of the items mentioned in your report are expenditures that are appropriate for a well-run hospital even though Medicare may choose not to pay for them all.
- 3) Audits and subsequent adjustments of Medicare cost reports are a routine part of a process for Virginia Mason and other hospitals; subsequent adjustments go both directions (Virginia Mason recently received \$553,522 of settlements relating to 1985 and 1986, and expects additional sums to be received). Our 1990 cost report has not yet been audited by our intermediary (Blue Cross); we expect both positive and negative adjustments to result from that audit.
- 4) Even if all of the items mentioned in your report were to be excluded from the Medicare cost report, the net effect would be to reduce Medicare payments by only \$15,000 (out of total annual payments of \$50,000,000), because very few Medicare payments are cost-based.

Mr. Herbert Witt
May 27, 1992
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- 5) While we appreciate the thoroughness of your review and the complexity of the Medicare regulations, we disagree with your interpretation of the regulations on most of the items. We will cooperate with our intermediary (Blue Cross) to have these items considered during their audit of our 1990 cost report, to see that we are only reimbursed for those items which are reasonable, necessary, and appropriate costs under Medicare regulations.
- 6) We are already engaged in an internal effort to identify similar items that may have been included in our 1991 cost report, and will propose adjustments as appropriate to Blue Cross. We will initiate a similar internal effort to identify such items in 1992 and the future.

Our detailed responses follow.

Advertising and Other Promotional Costs - \$200,421

The Medicare Provider Reimbursement Manual allows advertising and promotional costs if they are appropriate and helpful in developing, maintaining and furnishing covered services to Medicare beneficiaries-including presenting a good public image and communicating the availability of covered services. Advertising costs are not allowed if they seek to increase utilization. That distinction (communicating availability vs. increasing utilization) is at best vague.

We maintain that our media advertising (both print and broadcast) is intended to inform the public of the availability of services. We maintain that the cooking classes (presenting healthy ways to eat) and our activities with other Pacific Rim health care organizations are part of maintaining a good public image. The expenditure described as a booth on (See Note below.) women's health services intended to inform the public of those services.

Related Entity Training Costs - \$11,720

Virginia Mason is committed to the process of continuous quality improvement. Leadership commitment to this process is essential and involves sending board members, physician leaders and administrators to a training course at a college on the East Coast. While the physicians and some of the administrators are employees of Virginia Mason Clinic (a related non-profit organization), all of them are closely involved in hospital operations, and it was appropriate for the hospital to pay the expenses.

Mr. Herbert Witt
May 27, 1992
Page 3

Unsupported Costs - \$4,953

Costs without adequate support under your criteria included \$25 gift certificates for twenty-six employees totalling \$650, a volunteers' luncheon for \$838, a nursing retreat for \$250, a retirees luncheon for \$600 and service award tea expenses of \$286. In each of these cases, the expenditure was properly supported by a check requested and approved by an appropriate manager, but our files failed to include the original vendor invoice. While we agree our paper trail could be improved, we believe our existing documentation adequately supports the expense.

Lobbying Costs - \$4,222

The Provider Reimbursement Manual considers political contributions made directly to candidates to be unallowable, and also makes reference to indirect contributions; we would maintain that the indirect contributions phrase refers only to candidates.

The Committee for Affordable Health Care is a broad-based group working with policy makers and others to respond meaningfully to problems in the existing health care system, particularly access for low-income; lobbying was only a very small part of its activities. Citizens for Education was a group trying to pass a school levy (which we view as essential for training future employees). We believe both expenditures are appropriate and responsible.

Charitable Contributions - \$3,276

As noted in the report, \$3,000 was contributed to Partners in Public Education (PIPE), a civic organization organized to bring community businesses and high school students closer together. We believe such expenditures are related to patient care by training future employees. The Provider Reimbursement Manual (Section 2138.2) clearly allows dues, special assessments and meeting expenses for civic organizations, and we would assert that our participation in PIPE meets that definition. We are aware that a Provider Reimbursement Review Board opinion disallowed a contribution to a foundation for a medical staff seminar, but PRRB decisions are not binding on the hospital or its intermediary, and we believe the facts are different in this case.

Mr. Herbert Witt
May 27, 1992
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Membership Dues -

Office of Audit Services Note. Comments have been deleted at this point because they pertain to material included in the draft report but not included in this final report.

Another \$1,027 relates to monthly dues for the hospital administrator to the Rainier Club, used purely for business meetings with physicians and others, and not for general social purposes. We would assert that this is not a "social organization" (as described in Section 2138.3), since the activities are related to business. The final \$330 relates to dues in a variety of organizations, related to increasing our visibility among the Asian communities in Seattle. We would assert that these organizations meet the definition of Section 2138.2.

Miscellaneous - \$2,743

Of the \$1,113 of travel expenses, we agree that \$553 was correctly reimbursed by another hospital but erroneously charged to a non-reimbursable cost center, and that \$16 of flight instruction should not have been included. The remainder however, we believe are appropriate travel costs (we can find no indication of upgrade to first-class and no indication of duplicate payment).

The \$555 of expenses for a managers' dinner we would assert are an appropriate and normal expense related to attracting and retaining high quality department managers who need to relate to one another to render efficient patient care. The dinner followed a golf outing where the managers paid for their own golfing fees and their own alcoholic beverages.

The \$468 of alcohol consumed at a recognition dinner we would assert is a normal and appropriate expense related to attracting and retaining competent and motivated employees; these costs are surely modest. Although there is one PRRB decision disallowing the cost of alcohol at medical staff meetings, that decision is not binding on the hospital or its intermediary and the facts are somewhat different in our case.

The \$294 in supplies includes \$200 for Christmas cards were intended to maintain relationships with our existing sources of patients. We do agree that the \$49 of expenses related to a booth at a trade show should have been charged to a non-reimbursable cost center.

The \$187 of meals and miscellaneous charges were all appropriate to an organization planning and providing health care services. We do agree that \$126 in late and no-show charges could have been avoided and should be adjusted out.

Mr. Herbert Witt
May 27, 1992
Page 5

Costs of Concern - \$38,290

As noted in the report, these costs are not specifically unallowable under the Provider Reimbursement Manual, and the Office of the Inspector General is not recommending any adjustment to Virginia Mason's cost report.

The majority of the costs relate to employee benefits - directly to individuals, or indirectly to employees as a group. We have over 1,800 employees working at Virginia Mason. They are a dedicated group of highly qualified individuals. Implementing a set of personnel policies to keep them motivated to work effectively as a group is fundamentally related to high quality patient care.

The amounts of money involved and the types of activity they relate to are clearly appropriate. Some other expenses relate to activities of our unpaid volunteer board members. These activities are essential to our governance as a non-profit organization; the amounts of money and types of activities are clearly appropriate.

- \$8,542 relates to customary retirement gifts (in accordance with years of service) for seventeen individuals, none exceeding \$1,000.
- \$1,035 relates to plaques expressing appreciation to outstanding employees and retiring physicians.
- \$478 relates to a gift of camera equipment to a physician after serving ten years as chairman of the Quality Assurance Committee.
- \$319 of \$337 relates to a porcelain perfume bottle (*See Note.*) for a 35 year employee, in accordance with normal recognition policies.
- \$317 relates to fourteen glass boxes engraved with the Virginia Mason logo to express appreciation to the management retreat planning committee.
- \$274 relates to clocks engraved to express appreciation to two board members after completion of their term of office.
- \$200 relates to a gift certificate for a 35 year employee, in accordance with normal recognition policies.
- \$160 relates to a set of glasses engraved with the Virginia Mason logo to express appreciation to board members.

Mr. Herbert Witt
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Page 6

- \$5,648 relates to an annual summer picnic for all employees.
- \$1,014 relates to departmental lunches, dinners, picnics and celebrations, usually to celebrate the completion of projects or the accomplishment of goals.
- \$696 relates to a retirement dinner for a manager and \$302 for an annual luncheon for all Virginia Mason retirees.
- \$532 relates to an employee softball team.
- \$5,316 relates to the production and framing of pictures of the hospital board, given to the volunteer board members in recognition of their service to the hospital.
- \$1,821 relates to framed pictures and certificates of affiliated overseas hospitals and posters for an employee lounge.
- \$212 relates to the photographs of three board members to be hung on a wall near the hospital entrance so the public might know who the board members are.
- \$5,619 relates to service award pins for employees completing 5, 10, 15, 20 or 25 years of service to the hospital.
- \$1,050 relates to dinner gift certificates for 20 employees as recognition for 20 years or more of service, in accordance with normal recognition policies.
- \$4,136 relates to gifts of flowers or balloons to individual employees or for employee events on 69 separate occasions.

These amounts were not spent because they are reimbursable by Medicare (in fact, Medicare pays less than 10% of them through cost reimbursement). They were paid because they contribute to an atmosphere of cost-effective teamwork that has enabled Virginia Mason to keep its costs below other hospitals.

Mr. Herbert Witt
May 27, 1992
Page 7

Costs Not Allocated - \$120,704

We would point out, first of all, that this was a cost the hospital voluntarily excluded from its cost report, and no part of it was paid by the Medicare program.

The costs relate to a quarterly magazine, distributed to the medical community, employees, and existing patients of the medical center (not to the general public, as the report suggests). The articles generally describe advances in medical diagnosis or treatment, or advice on living in a healthy manner that are directly related to patient care and availability of covered services. We maintain that the magazine is not promotional in nature, but rather contributes to an understanding of the role and function of the hospital in providing covered services in the community.

On further review of the magazine's distribution and recent PRRB decisions (89-d57 and 90-d1), the hospital believes many of these costs legitimately meet the definition of Section 2136.1 and should be allowable costs for the Medicare program. We will work with the hospital's intermediary to consider revising the amount adjusted for 1990 and subsequent years.

Virginia Mason recognizes its responsibility as a not-for-profit organization to provide health care that is affordable and accessible. We will continue to monitor our expenditures to ensure they are consistent with this mission.

As mentioned in the beginning of this letter, we appreciate the opportunity to comment on your draft report and the professionalism with which your staff has approached this task. If you have further questions, please contact me at (206) 223-6918 or Paul Russell (206) 583-6026.

Sincerely,



H. E. Borgstrom, Jr.
Chief Financial Officer
Virginia Mason Medical Center

cc: Mr. Prad Gupta, Blue Cross of Washington-Alaska